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# **UNRELATED BUSINESS INCOME, CORPORATE SPONSORSHIPS, AND AFFINITY PROGRAMS**

**Presented by  
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This outline is presented for informational purposes and does not constitute legal advice.

## **A. OVERVIEW OF “UBIT”**

1. Tax-exempt organizations only escape payment of income tax on income that is “related” to their tax-exempt purposes. Common forms of tax-exempt income include:
  - a. Donations (including “sponsorship” fees)
  - b. Membership dues
  - c. Interest and dividend income from investments
  - d. Royalties paid for use of your intellectual property (such as licensing the use of your name/logo and renting your mailing list )
  - e. Rental income (if the nonprofit is totally passive)
2. By contrast, tax-exempt organizations must be tax on income that is from an “unrelated” business activity that is regularly carried on. The tax is referred to as the “unrelated business income tax” or “UBIT,” and it is reported on Form 990-T. The most common forms of taxable income for 501(c)(3) charities are:
  - a. Advertising income
  - b. Payments received in return for marketing/promotional services
  - c. Any other payments received in return for activities that are arguably commercial in nature and that compete with for-profit entities.

## **B. Overview of Corporate “Sponsorship” and Sponsor “Recognition”**

1. A nonprofit may receive a donation from any donor, and such donations are normally a form of tax-free income. The donor can take a charitable contribution deduction under certain circumstances.

2. Donations can include certain “sponsorship payments” by a for-profit corporation to sponsor an event or sponsor some or all of the costs of a nonprofit’s website. It is also permissible for a nonprofit to “acknowledge” a sponsor’s generosity and express appreciation for the sponsorship payment/donation.

3. By contrast, “advertising” income is almost always taxable to a nonprofit entity, since carrying paid advertising is usually a commercial (rather than a charitable, educational, religious, or similar tax-exempt) endeavor. Thus, in most cases, advertising income must be reported by a nonprofit as taxable “unrelated business income” on Form 990-T.

4. If a payment is received from a for-profit corporation in return for an acknowledgement that looks too much like an “advertisement” for the sponsor’s goods or services, the IRS may recharacterize the payment as a taxable advertising payment rather than a donation.

5. Thus, it is critically important to know the difference between a sponsor payment in return for which the sponsor receives only an “**acknowledgement**” that will not trigger any tax and a sponsor payment in return for which the sponsor receives an “**advertisement**” that will make some or all of the payment subject to the unrelated business income tax.

### C. What is a Permissible “Acknowledgement”

In determining whether a sponsorship payment is really a tax-free gift (as opposed to a taxable advertising payment), the IRS focuses on whether a corporate sponsor has any “arrangement or expectation that such [sponsor] will receive any substantial return benefit . . .” Internal Revenue Code § 513(i) (emphasis added). Thus, the question becomes what constitutes a “substantial return benefit.”

It would appear from the limited guidance that is available that the following items are acceptable forms of sponsor acknowledgement and could be offered by a nonprofit to its corporate sponsors without causing their sponsorship payments to become taxable to the nonprofit:

1. **Acknowledgement (either in printed media or on a nonprofit's website) of the corporate sponsor's name, logo, general phone number, locations, and Internet address.**
2. **Value-neutral displays of a sponsor's products or services, or distributing samples of a sponsor's products, at a nonprofit event.**
3. **A simple static Internet website link taking the reader only to the home page of the corporate sponsor.**

**EXAMPLE:** If Coca Cola wanted to pay money to sponsor a website page and also the annual conference of a nonprofit, both the website and the printed annual conference program could contain a message acknowledging the sponsor, such as:

**“This [website page] [conference] is sponsored by a generous donation from Coca Cola, 1111 N.W. 22nd Street, Atlanta, Georgia (phone: 800-123-4567); [www.Coke.com](http://www.Coke.com).**

- The website address could also be made into a simple “hyperlink” to the home page of the Coke website.
- In addition, the Coke logo could be displayed.
- Finally, it is permissible to have displays of Coke products at the conference or to hand out free samples of Coke at the conference.
- However, the displays of products or the website acknowledgement should not contain any language indicating value, price, or quality, or containing any inducement to purchase Coke products.

#### **D. What is Likely to be Deemed an “Advertisement” or “Return Benefits” Triggering UBIT**

It would appear from the IRS guidance that is available that the following forms of sponsor acknowledgements or benefits will likely be deemed by the IRS to constitute “advertising” or a “substantial return benefit” for the sponsor. Payments to a nonprofit entity from such sponsors likely will

be taxable to the extent of the value of the advertising or substantial return benefit:

**1. Providing prices, qualitative information, or other indications of savings or value; or providing endorsements or inducements to buy/lease the sponsor's products or services.**

(Note: There is some authority indicating that it is permissible to include with a sponsor acknowledgement any "promotional slogans that are an established part of the sponsor's identity." However, this exception has not been defined and could carry some risks.)

**2. Providing an "active placard" or a "running banner" with the sponsor's name or logo on a nonprofit's website.**

(Note: An IRS official has indicated informally that this may not be a hard and fast rule.)

**3. Providing a website link that takes the user directly to the page of the sponsor's site where products or services can be ordered, or listing the specific phone number for ordering products or services from the sponsor.**

**4. Providing more than token facilities, services or other privileges to the sponsor in return for its sponsorship payment.** Examples might include providing sponsors with complimentary sports or theater tickets, special briefings or reports not available to the public, or lavish receptions.

**5. Accepting a sponsorship payment from a corporation where the amount of the payment is contingent upon the level of attendance at a charity event, broadcast ratings, or other factors indicating the degree of public exposure to an activity.**

(Note: What about accepting a sponsorship payment contingent on the number of "hits" that occur on a website page or contingent on the number of people who link to the sponsor's website and purchase products? There is no clear law on the point, but it

would seem very risky in light of the foregoing guidance.)

**6. Providing sponsors with advertising or acknowledgements printed in a nonprofit's regularly scheduled and published materials (i.e., in a "periodical").**

(Note: This rule appears to be limited to printed periodicals, such as regularly-scheduled magazines published by a nonprofit, although the IRS is examining whether some nonprofit websites might also have the same characteristics as a printed "periodical.")

WEBSITE HYPER LINK EXAMPLE: Assume that on a nonprofit's website, the logo of a software company corporate donor is also accompanied by the statement:

**"Speed up your downloads by clicking here."**

Assume also that clicking on the above phrase leads directly to the order page of the corporate sponsor where the viewer is given a choice of ordering a particular type of software that will speed up downloads of Internet information.

The IRS is of the view that this type of link would most likely be considered advertising (thus making the sponsorship payment taxable to the nonprofit), regardless of whether the viewer on the nonprofit's web page actually clicks on the link or not.

The reason is that the statement above is a direct "inducement" to purchase something from the corporate donor, and in addition, the link takes the reader solely to the ordering page of the website and not merely to the home page.

**E. Planning Considerations**

1. If a corporation seeks to enter into an arrangement with your nonprofit organization in which the corporation would pay an advertising fee in return for having an advertisement carried on your website, see if the corporation might instead want to become a

corporate “sponsor” and make a “donation” in return for an “acknowledgement.” In many instances, it is possible to fashion a sponsor “acknowledgement” that would not look much different than the advertisement that the corporation initially wanted, and the entire sponsorship payment is then tax-free.

2. Be VERY careful in the way you word any written solicitation for corporate sponsors! Avoid promising them “advertising.”
3. Avoid letting the sponsor draft its own acknowledgement statement, since sponsors do not know the tax exemption rules and may inadvertently end up writing an advertisement.
4. For long-term sponsorship arrangements, use a formal written contract, rather than relying on a vague oral understanding.
5. If you do decide to carry paid advertising on your website, be sure to charge “fair market value” for such advertising.
  - Consider also segregating the paid ads from the corporate sponsor acknowledgements.

## **F. Corporate Affinity Arrangements**

Many corporations seek to have an “affinity” arrangement with a nonprofit in order to obtain access to your members and sell them goods or services. This can include banks, credit card companies and various other types of vendors.

1. You can rent your mailing list to a vendor in return for a “royalty,” which is tax-free income.
2. You also can license the use of your name and logo to a vendor in return for a “royalty.”
3. But, if a nonprofit performs any services for the vendor (and especially if the nonprofit performs marketing, promotional, advertising or endorsement services), then the IRS takes the position

that the value of the advertising or services is subject to UBIT.

4. Therefore, it is important to avoid mixing promotional and advertising services into an affinity royalty agreement. Instead, remain as passive as possible and let the vendor do all of the promotion and advertising.
5. If you must include promotional and advertising services, consider putting them in separate agreements. If they are included in a single agreement, the payment for the advertising and services should be segregated from the royalties for use of the nonprofit's name and logo to demonstrate that they were separately valued by the parties; making it less likely that an IRS auditor will value them differently.